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Racism, Capitalism, and Predatory Lending: How the U.S. Government's Failure to Regulate the Disproportionate Negative Effects of Payday Lending in Black Communities Violates the International Convention on the Elimination of All Forms of Racial Discrimination

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RACISM, CAPITALISM, AND PREDATORY LENDING: HOW THE U.S. GOVERNMENT'S FAILURE TO REGULATE THE DISPROPORTIONATE NEGATIVE EFFECTS OF PAYDAY LENDING IN BLACK COMMUNITIES VIOLATES THE INTERNATIONAL CONVENTION ON THE ELIMINATION OF ALL FORMS OF RACIAL DISCRIMINATION

PAULINA E. DAVIS*

I. INTRODUCTION

In 2009, two issues have received intense attention in the media; the first issue being the candidacy and election of the first Black president of the United States, and the other being the global economic meltdown. The election of Barack Obama catapulted an important, albeit diluted, conversation on race relations in this country as it specifically relates to the progress of human rights and Black people. Discussions surrounding the financial crises focused on the practices on Wall Street and the dire consequences of predatory practices in the finance industry. These two concepts, race relations and predatory capitalism, rarely converge in debate or conversation; yet, the two have a relationship that extends back before the founding of the United States.

Racial animus is rarely examined in the context of contract formation even though the buying and selling of Black people as slaves is at the cornerstone of this country's economic foundation and

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growth.[1] With the exception of a few rare instances that will be discussed further below, this article asserts that America's history is devoid of any government acknowledgement of racism in predatory commercial transactions. The enactment of the Peonage Act of 1867[2] and the United States Supreme Court's subsequent decisions in the Peonage Cases provide examples of when the government considered, and quickly dismissed racism in contract formation and enforcement.

This article asserts that the federal government has previously facilitated and ignored racist economic predatory practices, and in doing so, has made Black communities vulnerable to predatory practices in commercial transactions like payday lending. Although, the United States has signed and ratified the International Convention for the Elimination of All Forms of Racial Discrimination (hereinafter, "CERD" or "Convention"), it has failed to meets its obligations under the Convention.[3] Congress should take the next step in addressing this problem by incorporating the broad definition of "racial discrimination" that is included in Article 1 of CERD into domestic laws.[4] Specifically, Congress should enact legislation that protects Black communities from payday lending practices, which as will be discussed, have a disproportionate negative economic impact on Black communities as compared to White communities.[5]

Part II of this paper discusses the concept of "unconscionability" in contract law as a framework for understanding the unequal bargaining power that Blacks have in predatory payday lending transactions as a result of racism. Part III explores the

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[1] *See generally* VOLUME 1 or 2 JOE WILLIAM TROTTER, JR., THE AFRICAN AMERICAN EXPERIENCE 56-79 (1st ed. 2001) (explaining the role of the slave trade in shaping capitalism in British North America).

[2] Peonage Act of 1867, ch. 187, 14 Stat. 546 (1867).

[3] United Nations, Treaty Collections, International Convention for the Elimination of All Forms of Racial Discrimination, http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IV-2&chapter=4&lang=en (last visited Aug 16, 2011) (listing the States that have signed and ratified the Convention).

[4] International Convention for the Elimination of All Forms of Racial Discrimination art. 2 (1)(d), Dec. 21, 1965, 660 U.N.T.S. 195, *available at* http://www2.ohchr.org/english/law/pdf/cerd.pdf (last visited Aug. 15, 2011) [hereinafter, CERD].

[5] *Id.*

relationship between racism and capitalism in this country with specific references to peonage contracts and crop-lien agreements. The purpose of Part III is to show how the formal institution of racism and historical lack of governmental protections have made Black communities more susceptible to predatory commercial practices. The history of and relationship between capitalism and racism is important because, as will be explained, the purpose of CERD is to correct the disadvantages and vulnerabilities created by institutional racism. The paper continues in Part IV by examining a study of payday lending institutions that demonstrates that such businesses have a disproportionate negative economic impact on Black communities. Part V explains the purpose of CERD, its definition of "racial discrimination," and the United States' obligations under the Convention to prohibit the impairment of economic development in Black communities. Finally, Part VI proposes that Congress begin meeting its obligations under CERD by enacting legislation that regulates payday lending in Black communities.

II. THE TRANSACTIONAL CAPACITY APPROACH TO THE UNCONSCIONABILITY DEFENSE IS A FRAMEWORK FOR UNDERSTANDING WHY RACISM HAS MADE BLACK COMMUNITIES VULNERABLE TO PREDATORY PAYDAY LENDING.

A predatory lender can be defined as a lender who obtains profit by engaging in unfair, but legal, transactions.[6] Typically, predatory lenders engage a specific consumer population because of its inexperience and lack of information and because of the lenders' ability to manipulate the target into acquiring unaffordable products or services.[7] In other words, lenders target certain populations

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[6] Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 Minn. L. Rev. 21 (Nov. 2002), *available at* 87 Minn. L.Rev.1, *5 (LEXIS).

[7] DEBORAH GOLDSTEIN, JOINT CTR. FOR HOUSING STUDIES HARVARD UNIVERSITY, UNDERSTANDING PREDATORY LENDING: MOVING TOWARDS A COMMON DEFINITION AND WORKABLE SOLUTION 7 (1999), http://www.jchs.harvard.edu/publications/finance/goldstein_w99-11.pdf. (last visited Aug. 15, 2011) (noting that "predatory lending" has been used to refer to pay

because that they believe these groups are less likely to exert their power in contract negotiations. We see the concept behind this predatory lending dynamic in law professor Melvin Eisenberg's argument for the expansion of the application of the unconscionability defense.[8]

In his article, *The Bargain Principle and Its Limits*, Eisenberg defines "bargain" as "an exchange in which each party views the performance that he undertakes as the price of the performance undertaken by the other."[9] He defines "bargain principle" as "the common law rule that, in the absence of a traditional defense relating to the quality of consent, . . . courts will enforce a bargain according to its terms."[10] The theory of unconscionability is found in common law and also articulated in the Uniform Commercial Code (hereafter, "UCC").[11] It allows courts to deviate from the bargain principle and refuse to enforce a contract that is unconscionable as a matter of law.[12]

Eisenberg asserts that the theory of unconscionability is a necessary limitation on the bargain principle because contracts are sometimes formed in the marketplace under circumstances not contemplated by the bargain principle.[13] He posits that the enforcement of contracts formed under these circumstances would be unfair.[14] Furthermore, Eisenberg rejects the court's traditional approach to applying the unconscionability defense characterizing such approach as rigid and failing to account for the true limits of the bargain principle.[15] In that regard, Eisenberg advocates for an analytical framework for the application of the unconscionability

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day lending and other services, but focusing on predatory lending in the context of home equity lending).

[8] Melvin Aaron Eisenberg, *The Bargain Principle and Its Limits*, 95 Harv. L. Rev. 741, 754 (1982).

[9] Eisenberg, *supra* note 9, at 741.

[10] *Id.*

[11] Restatement (Second) of Contracts § 208 (2011); U.C.C 2-302(1) (2009).

[12] U.C.C. § 2-302(1).

[13] *See* Eisenberg, *supra* note 9, at 753-54 (describing cases where the courts used the unconscionability defense to modify terms of a contract as anomalies under the bargain principle).

[14] *Id.*

[15] *Id.*

defense that focuses on the quality of the parties' bargain and the fairness and efficiency that would be lost if the court enforced an unfair contract under the bargain principle.[16]

While Eisenberg describes four situations that he asserts are paradigms for the application of the unconscionability defense,[17] one of those models, namely the transactional capacity model, is relevant to a discussion of predatory lending practices in Black communities. Transactional incapacity is the idea that a seller enters a contract with an individual when the seller knows that the contract involves highly complex subject matter and that the individual lacks the requisite aptitude and experience to make a deliberative, well-informed decision.[18] The seller uses this information about the potential buyer to induce him to make a bargain, knowing that similar tactics would not work on an informed consumer who has more experience with that type of transaction.[19] The term "bargaining power" is used in this article to describe the ability of one party to exert her will on the other when negotiating the terms of her performance. Eisenberg asserts that under circumstances where a party enters into negotiations with a party that has transactional incapacity; the use of the bargain principle to enforce such contracts would yield unfair results.[20]

To illustrate his point, Eisenberg highlights the facts from *Williams v. Walker-Thomas*[21] to show how the transactional capacity paradigm could be used in the application of the unconscionability defense. In *Williams*, the named plaintiff in the class action suit, Ora Lee Williams, defaulted on a payment in a "lease-to-own" installment contract that she entered into with the defendant, Walker-Thomas furniture store.[22] The defendant's standard contract provided that all installment payments would be rolled into one so that a balance remained on all items purchased from the store until the customer

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[16] *Id.*
[17] *See* Eisenberg, *supra* note 9, at 754-785.
[18] *Id.* at 763.
[19] *Id.*
[20] *See id.*
[21] Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965).
[22] *Id.* at 447. A lease-to-own contract is one in which the store retains title of the item until the purchaser makes all of the monthly installment payments for the value of the item plus the interest. *Id.*

paid the entire balance on the current lease.[23] In other words, if the customer defaulted on a payment for any item purchased, then the store had the right to repossess all of the items previously purchased.[24] This would occur even if the customer paid in full for some of the previously leased items.[25] The United States Court of Appeals for the District of Columbia ("D.C. Circuit Court") remanded the case to the lower court holding that the court erred in rejecting the plaintiffs' defense of unconscionability.[26] Judge J. Skelly Wright delivered the opinion of the court stating that:

> Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party . . . . In many cases the meaningfulness of the choice is negated by a gross inequality of bargaining power.[27]

Ora Lee Williams was a Black woman, a fact that the D.C. Circuit Court did not include in its discussion of the installment contract.[28] According to one scholar, Judge Wright later stated in an interview about the *Williams* case that the stereotypical features of the plaintiff class were among his considerations when weighing the fairness of the provision.[29] In the *Williams* opinion, Judge Wright wrote that "when a party of little bargaining power, and hence little real choice, signs a commercially unreasonable contract with little or no knowledge of its terms, it is hardly likely that his consent, or even an objective manifestation of his consent, was ever given to all the

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[23] *Id.*
[24] *Id.*
[25] *Id.*
[26] *Id.* at 450.
[27] *Id.* at 449.
[28] Muriel Morisey Spence, *Teaching Williams v. Walker-Thomas Furniture Co.*, 3 TEMP. POL. & CIV. RTS. L. REV. 89, 90 (Oct. 1993) (explaining that the case implicates stereotypes about African-American women as fiscally irresponsible welfare recipients).
[29] *Id.*

terms."[30] He went on to state that "[i]n such a case the usual rule that the terms of the agreement are not to be questioned should be abandoned and the court should consider whether the terms of the contract are so unfair that enforcement should be withheld."[31]

Eisenberg argues that most courts analyzing the *Williams* contracts would not deem them unconscionable as a matter of law; unless, the evidence demonstrated that the defendant in *Williams* placed the terms in an inconspicuous place in the contracts.[32] Eisenberg rejects this approach and posits that such terms, regardless of their placement in the contract, should be unenforceable when buyers lack the transactional capacity to understand them.[33] Eisenberg makes a poignant analysis of the *Williams* case using his transactional incapacity theory. However, this article asserts that because Eisenberg fails to account for the racial and social dynamics at play in *Williams*, he misses a valid aspect of the bargaining relationship between plaintiffs and defendant in that case.

As will be explained in Part III, Black communities have experience with installment contracts[34] and other commercial contracts with exploitive terms; therefore, these communities do not have transactional incapacity as contemplated by Eisenberg. However, because these communities lack experience exerting their bargaining power in certain commercial contract negations, they lack transactional experience. Accordingly, the principles underlying the unconscionability defense would still apply under Eisenberg's transactional incapacity framework. When the history and relationship between racism and capitalism in America is examined in the context of commercial transactions using Eisenberg's

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[30] Williams, 350 F.2d at 450.
[31] *Id.*
[32] Eisenberg, *supra* note 9, at 773.
[33] *Id.*
[34] Martha Olney, Professor of Economics, examined racial borrowing patterns in a 1918-1919 Bureau of Labor Statistics Consumer Purchases Survey ("BLS"), and found that merchants utilized installment payments systems with Blacks while allowing Whites to purchase items on credit. Martha L. Olney, *When Your Word Is Not Enough: Race, Collateral, and Household Credit*, 28 J. ECO. HIST. 408, 408-10 (1968).

transactional incapacity model as a lens, then we can see how racism has systematically weakened and hindered the ability of Black communities to exert their bargaining power in commercial transactions. Payday lending contracts provide an illustration of this theory. As will be explored later, these contracts have the disproportionate effect of extracting wealth from Black communities.

III. RACISM IS ENTRENCHED IN THE HISTORY OF COMMERCIAL TRANSACTIONS INVOLVING BLACK COMMUNITIES IN THE UNITED STATES.

A. Chattel Slavery

The passage of laws that condemned Africans and their descendants to life-long servitude[35] marked the beginning of a complex relationship between White business owners, the government, and Black communities. The buying and selling of slaves constituted a commercial transaction in which White businessmen bartered for enslaved Africans.[36] Seeing the economic profits and prosperity extracted from forced African labor, the government made chattel slavery a more efficient and effective business model by subjugating Blacks to a life of servitude.[37] The government thus facilitated a formidable and perpetual system of Black exploitation in the commercial market.

The *Dred Scott* case further supported this model when the Supreme Court decided that the U.S. Constitution afforded no rights or privileges to persons of African descent because they were not "people" or "citizens" of the United States;[38] but rather "a subordinate and inferior class of beings, who had been subjugated by the

[35] See generally JOE WILLIAM TROTTER, THE AFRICAN AMERICAN EXPERIENCE 76-78 (Houghton Mifflin Co., 2001).
[36] HOWARD ZINN, A PEOPLE'S HISTORY OF THE UNITED STATES 25 (Deluxe ed. 2010).
[37] *See generally id.* at 30.
[38] Dred Scott v. Sanford, 60 U.S. 393, 405 (1856).

dominant race . . . ."[39] Furthermore, Chief Justice Taney depicted the relationship between racism and capitalism by stating:

> [t]he negro might justly and lawfully be reduced to slavery for his benefit. He was bought and sold, and treated as an ordinary article of merchandise and traffic, whenever a profit could be made by it. This opinion was at that time fixed and universal in the civilized portion of the white race.[40]

The Court's decision in *Dred Scott* stripped Black people of their right to petition U.S. courts to address any of their grievances including those of a commercial nature. In analyzing the *Dread Scott* opinion, we see how the federal government created a class of people that merchants could easily target for predatory commercial practices. A person who has no enforceable rights in court must also lack equal bargaining power in contract negotiations. This article asserts that the *Dred Scott* decision had both legal and economic impacts that affected Black people in the Reconstruction era and beyond.

B. Debt Peonage

By the end of the Civil War, Black people were emancipated, but they were far from free.[41] In the postbellum South, the economic structure remained virtually unchanged as White planters continued to exploit Black people as a cheap labor source.[42] Some Blacks procured from emancipation an opportunity to improve their economic status by purchasing small plots of land.[43] Others found themselves with new financial obligations and no work.[44] This

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[39] *Id.* at 404-05.
[40] *See id.* at 404-05.
[41] *See generally* CARTER WILSON, RACISM: FROM SLAVERY TO ADVANCED CAPITALISM 79 (Sage Publications, 1996).
[42] *See generally id.* at 84.
[43] *Id.*
[44] CYNTHIA M. DUNCAN, WORLDS APART: WHY POVERTY PERSISTS IN RURAL AMERICA 90 (Yale Univ. 1999).

combination of circumstances fashioned the perfect temperament for new expressions of old racist predatory practices.

1. The Role of the Judiciary in the Enforcement of Peonage Contracts

State governments enacted Black Codes that facilitated this evolved system of slavery by making vagrancy and similar acts illegal.[45] Under these Codes, judges subjugated Blacks by punishing them with unaffordable fines, inflated court costs, and hard labor on the chain gang.[46] At sentencing hearings, White planters offered to pay fines on behalf of Black Code violators in exchange for labor to extinguish the debt.[47] Many judges supervised and approved the contracts entered into between the Code violator and the Planter; and if a Code violator failed to adhere to the terms of the "deal," the court sentenced him to a longer period of hard labor on the chain gang.[48] In theory these contracts, called convict-leases, applied to everyone, but in practice, courts arranged them mostly for Black people.[49]

While states, not the federal government, enacted Black Codes and created and enforced convict-leases, the federal government actively supported these racist policies.[50] Officers from the Freedman's Bureau considered convict-leases "wholesome compulsion" for freedmen who they believed lacked the work ethic and mental capacity to enter into free-market, fair labor agreements.[51] In a litany of cases known as the Peonage Cases, an opportunity to condemn convict-leases as slavery in violation of the Thirteenth Amendment and the Equal Protection Clause of the Fourteenth

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[45] Benno C. Schmidt, Jr., *Principal and Prejudice: The Supreme Court and Race in the Progressive Era. Part 2: The Peonage Cases*, 82 COLUM. L. REV. 646, 648-49 (1982).
[46] *Id.*
[47] *Id.* at 650.
[48] *Id.* at 651, 699.
[49] *Id.*
[50] *Id.* at 654.
[51] Schmidt, *supra* note 46, at 650.

Amendment presented itself to the Supreme Court.[52] But the Court forfeited this opportunity to directly address the racial animus of these economic transactions and the courts' role in enforcing these agreements.[53] Instead, the Court condemned the state's action in enforcing such agreements as an inhibition on man's freedom to create and breach contracts.[54]

Congress enacted the Peonage Act because convict-leases violated the Thirteenth Amendment.[55] Nevertheless, courts in a series of cases known as the Peonage Cases often allowed White planters to escape liability under the Act. The Supreme Court in *Clyatt v. United States* defined "peonage" as "a status or condition of compulsory service, based upon the indebtedness of the peon to the master."[56] It further explained that the condition existed even absent enforcement by law so long as two parties contracted for the exchange of labor for money and the debtor could not elect to release himself from the contract.[57] Despite this broad definition of peonage, the Court in *Clyatt* reversed the trial court's conviction of a defendant under the Act, even though the defendant traveled to Florida to forcibly return two Black men to Georgia to work off a debt that they owed to him.[58] Because the state charged the defendant with "returning" one to peonage, it had to provide explicit testimony demonstrating that the two Black men had previously existed in the condition and that the defendant specifically returned them to that circumstance.[59]

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[52] *See generally* Bailey v. Alabama, 219 U.S. 219, 227 (1911); United States v. Reynolds, 235 U.S. 133, 138 (1914).

[53] *See* Bailey, 219 U.S. at 231 (Justice Hughes stating, "We at once dismiss from consideration the fact that the plaintiff in error is a black man. While the action of a state, through its officers charged with the administration of a law fair in appearance, may be of such a character as to constitute a denial of equal protection of the laws, such a conclusion is here neither required nor justified. The statute, on its face, makes no racial discrimination, and the record fails to show its existence in fact.").

[54] *Id.*

[55] Peonage Act, *supra* note 3.

[56] Clyatt v. United States 197 U.S. 207, 215 (1905).

[57] Clyatt, 197 U.S. at 215 (quoting Jaremillo v. Romero, 1 N. M. 190, 194 (N.M. Terr. 1857)).

[58] *Id.* at 222.

[59] *Id.*

According to the Court, the state failed to make a sufficient showing of this fact and thus it overturned the defendant's conviction.[60] The Court's rigid interpretation of the statute and feigned ignorance to the reality of peonage agreements only further perpetuated the racism underlying these contracts.

After the decision in *Clyatt*, the Supreme Court had another opportunity to address the racial animus of peonage contracts, but again chose not to do so. In *Bailey v. Alabama*, the Court struck down an Alabama code as unconstitutional where the code punished persons who executed contracts with intent to defraud their employer because the statute presumed intent to defraud anytime someone failed to perform or repay payment advancements without just cause.[61]

The state charged the defendant Bailey under the Alabama code because he breached a contract with Riverside Company.[62] The contract required Bailey to work for the company for a year in exchange for a cash advance.[63] Even though the record indicated that Bailey was a Black man, the Court dismissed racism as a rationale for the statute and failed to address its unequal application to Black people.[64]

The Court declared the Alabama statute unconstitutional on the grounds that without actual evidence of intent to defraud, conviction for breach of a contract amounted to a conviction for failure to pay a debt, which violated the Thirteenth Amendment and the Peonage Act.[65] The Court went on to minimize further the racial implications of the Alabama statute by stating "while the immediate concern [of the Thirteenth Amendment] was African slavery, the Amendment was not limited to that. It was a charter of universal civil freedom for all persons, of whatever race, color, or estate, under the flag."[66] Also, the Court's refusal to address the statute as a violation

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[60] *Id.*
[61] *See* Bailey, 219 U.S. at 219.
[62] *Id.* at 229-30.
[63] *Id.*
[64] *Id.* at 231-32.
[65] *Id.* at 239, 242.
[66] *Id.* at 240-41.

of the Equal Protection Clause of the Fourteenth Amendment, further de-emphasized the disproportionate amount of peonage contracts between Black farmers and White planters.[67] This article contends that the Court's failure to address the racism in these cases is important because it allowed Congress and the Judiciary to continue to overlook the unchecked racial violence and retaliation that existed in interracial commercial transactions in the South.

When racists White farmers stopped relying on the police and the state to enforce their peonage contracts and when they faced criminal charges for returning Blacks to peonage, these farmers unleashed an unprecedented reign of violence and terror on Black communities.[68] Although, the U.S. Attorney's office pursued convictions for White planters who violated the Peonage Act,[69] but acts of violence committed by racists Whites against Blacks went relatively unpunished.[70] Historian Eric Foner describes a violent response from the Ku Klux Klan (hereinafter, "Klan") toward Black sharecroppers and farm laborers who questioned exploitive contracts.[71] For example, he notes that the Klan beat a Black man for suing his debtor in court, because "darkeys were through with suing white men."[72] They whipped another Black man for challenging a planter that cheated him out of his crop share.[73] Basically, the Klan decided to "compel [Blacks] to do by fear what they were unable to make them do by law."[74] This reinforcement made continued economic exploitation of Blacks easier in Reconstruction and made

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[67] *See* Schmidt, *supra* note 46.

[68] ERIC FONER, RECONSTRUCTION AMERICA'S UNFINISHED REVOLUTION 1863-1877, 425 (Henry Steel Commager & Richard B. Morris eds., Harper & Row) (1988).

[69] Schmidt, *supra* note 42, at 671 (explaining the findings of Attorney General Charles W. Russell, special investigator and prosecutor to coordinate federal action against peonage).

[70] FONER, *supra* note 69, at 428-29.

[71] *Id.* at 428.

[72] *Id.* at 429 (internal quotations omitted).

[73] *Id.*

[74] *See id.* (quoting a Democratic judge from Alabama and explaining that the Klan sought to take over the "labor control function" that the state government used to serve but that Congress forced it to abandon during Reconstruction) (internal quotations omitted).

bargaining in these commercial transactions dangerous for Black people.[75]

We can say that as the Supreme Court did not discuss the racism underlying convict leases in the Peonage Cases, the federal government could assert that the passage of the Peonage Act and the prosecution of some of its violators sufficiently addressed the exploitive economic practices of slavery in the postbellum South.

2. Crop-Lien Agreements

Through sharecropping, White planters maintained a system of economic hierarchy that reflected the racist undertones of slavery.[76] Planters did not limit the sharecropping structure to the formerly enslaved, but Blacks constituted a disproportionate majority of the sharecropper class.[77] Only 13% of Blacks claimed ownership to the land they plowed and sowed in contrast to the 42.4% of White farm laborers who owned the land they worked.[78] Also, a hierarchy existed within the sharecropping world that reflected an uneven racial distribution of White farmers making up the majority in the more equitable landlord-tenant arrangements and Blacks mostly occupying the poorest class of peons.[79] Recently emancipated Blacks owned very little, and thus many of them worked as sharecroppers providing labor in exchange for a percentage of their harvested crops.[80]

After the Civil War, a shortage in capital created a huge market for a credit system where farmers received supply advances from merchants in exchange for a percentage of their crops.[81] Once sold, the crops would yield enough cash to cover the price of the supplies and the interest charged on the advance.[82] Some White planters opened merchant stores on their plantations after they

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[75] *See generally* FONER, *supra* note 69.

[76] WILSON, *supra* note 42, at 82.
[77] *Id.* at 85.
[78] *Id.*
[79] *Id.*
[80] *Id.*
[81] FONER, *supra* note 69, at 394.
[82] *Id.*

realized that many Black sharecroppers used their crop shares as collateral to repay merchants for farming supplies advanced to them at high interest rates.[83] Therefore, being a landlord and a merchant could allow planters to "double-dip" so to speak by allowing them to receive a larger percentage of the sharecropper's harvest. Both independent merchants and planter merchants, loaned supplies to Black sharecroppers on household credit lines and required repayment at an average interest rate of 71%.[84] This rate often represented three times the amount of interest that White planters paid on their credit lines.[85] Thus, the rate of return that sharecroppers received at harvest time paled in comparison to the cost of purchasing supplies. Foner quotes one Black resident of Mississippi as saying the "crops ha[d] been mortgaged for supplies before they ha[d] been planted."[86]

Independent merchants often required sharecroppers to obtain a guarantor or the co-signature of the sharecropper's landowner-employer as a condition of granting the loan.[87] Whites measured creditworthiness not only by a Black sharecropper's ability to repay, but also by the level of deference he or she showed to the planter.[88] More disturbingly, the Klan used violence against Blacks that defied White planters and against merchants who treated Blacks fairly in commercial transactions.[89] Furthermore, as desired by the Klan,[90] an inability to repay the planter or vendor had far reaching consequences on the economic prosperity and mobility of Black sharecroppers because their creditworthiness often dictated their mobility and ability to seek employment with other planters.[91]

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[83] *Id.* at 406.
[84] JAY R. MANDLE, NOT SLAVE, NOT FREE: THE AFRICAN AMERICAN ECONOMIC EXPERIENCE SINCE THE CIVIL WAR 42 (Duke University Press 1992).
[85] *Id.*
[86] FONER, *supra* note 69, at 408.
[87] MANDLE, *supra* note 85.
[88] *Id.*
[89] FONER, *supra* note 69, at 429, 431(explaining that the Klan killed a Jewish merchant known for his fair dealings with Black customers, along with many Black people during a massacre in Jackson, Florida).
[90] *Id.*
[91] MANDLE, *supra* note 85.

From this recitation of history, we can see that the Peonage Act and subsequent Peonage Cases along with the rise of Klan violence show that although Planters could not legally enforce convict leases, they had other means to enforce contracts for the exploitation of Black labor. Therefore, using the definition of unconscionable as set forth in the *Williams* case, we can say that these crop lien contracts were unconscionable because Black communities did not have a meaningful choice in the negotiation of such contracts and because the terms of such contracts unreasonably favored White planters and merchants. This article posits that this environment left Black communities with the experience of having little to no bargaining power when negotiating commercial contracts. As a result, Black communities ended up in exploitive contracts in disproportionate numbers. This analysis serves as the basis for this article's assertion that Black communities have a transactional incapacity in commercial contract negotiations that makes them vulnerable to predatory payday lending practices. As will be explained in the proceeding section, the business operations of payday lenders show how business entities take advantage of this transactional incapacity in Black communities today.

IV. PAYDAY LENDING

A payday loan is as a relatively small loan given to a consumer over an average period of 14 days in exchange for a postdated check.[92] The postdated check serves as collateral for the loan and is returned by the lender upon satisfaction of the debt.[93] Lenders make these loans at an average annual percentage interest rate of 390% or approximately fifteen to twenty dollars for every

[92] Gregory Elliehausen, Ph.D. & Edward C Lawrence, Ph. D., *PayDay Advance Credit in America: An Analysis of Customer Demand* (2001), *available at* http://www.fdic.gov/bank/analytical/cfr/2005/jan/CFRSS_2005_ellehausen.pdf (last visited Aug. 29, 2011).
[93] *Id.* at 1.

$100 borrowed.[94] However, in some instances payday lenders charge an annual percentage rate of up to 910%.[95]

An example of a payday-lending contract is illustrative of how the transaction works. In *Johnson v. Cash Store*, the plaintiff, a fast-food restaurant manager, needed money to pay her bills after paying an unexpected medical bill for the family pet.[96] The plaintiff went to a payday lender for a small cash advance of $250.[97] The clerk at the payday lender advised the plaintiff that she should apply for a loan of $500 in order to receive a better interest rate.[98] The woman agreed and gave the lender a postdated check for $575 to cover the cost of the loan and the interest fee.[99] The plaintiff walked away from the transaction with the understanding that the lender would return the postdated check when she returned to the lender in two weeks with $575 in cash.[100]

The date for payment arrived, and the plaintiff could not afford to pay the full amount of the loan.[101] The clerk at the payday lender told the plaintiff to bring $575 in cash to the lender so that she could "rollover" her loan.[102] To rollover her loan, the woman had to sign a new agreement promising to pay the entire $575 two weeks

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[94] *Id.* at 3.

[95] Johnson, *supra* note 7, at *2(discussing the court's calculation of the interest fee charged to the payday borrower plaintiff in Cashback Catalog Sales, Inc. v. Price, 102 F.Supp.2d 1375, 1379n.3 (S.D. Ga. 2003)); Wei Li et. al, Predatory Profiling: The Role of Race and Ethnicity in the Locations of PayDay Lenders in California, Center for Responsible Lending 2 (2009) *available at* http://www.responsiblelending.org/california/ca-payday/research-analysis/predatory-profiling.pdf (last visited Aug. 15, 2011) (noting that the average interest rate charged for payday loan is up to 490%); CONSUMER FED. OF AM., RENT-A-BANK PAYDAY LENDING: HOW BANKS HELP PAYDAY LENDERS EVADE STATE CONSUMER PROTECTIONS 4 (2001), *available at* http://www.consumerfed.org/pdfs/paydayreport.pdf (last visited Aug. 16, 2011) (surveying payday lenders and finding that they charge borrowers, on average, an annual percentage rate between 18.2% and 910%).

[96] Johnson v. Cash Store, 68 P.3d 1099, 1102 (Wash. Ct. App. 2003).

[97] *Id.*

[98] *Id.*

[99] *Id.*

[100] *Id.*

[101] *Id.*

[102] Johnson, 68 P.3d at 1102.

from the date of the new agreement.[103] After signing the new agreement, the plaintiff gave the clerk the full $575 in cash, of which the clerk kept $75 and returned the remainder.[104] This ping-pong of money and loan agreements between the plaintiff and the defendant continued for 14 more rollover transactions where each time the lender kept an amount reflecting the finance charge for each loan and gave the woman $500.[105] Seven months from the date of the original payday loan of $500, the plaintiff found that she had paid more than $1,100 in interest fees on her loan but still maintained a debt for the principal balance of $500.[106] After the plaintiff stopped payment on a postdated check held by the defendant, the defendant threatened the plaintiff by saying that she would go to prison if she failed to repay the loan.[107] Ultimately, the plaintiff paid the defendant which resulted in a foreclosure on her trailer and an incurred debt of $20,000 on her foreclosed home.[108]

The Center for Responsible Lending (hereinafter, "CRL") conducted a recent study of payday lending in California.[109] According to the study, payday lenders target Black and Latino communities by maintaining more storefronts in neighborhoods with a high concentration of African-Americans and Latinos.[110] Researchers conducted the study by performing a regression model that controlled for other variables that could explain the concentration and location of payday lending in Black and Latino communities.[111] The researchers also used group–block data collected in the U.S. Census in 2000 to determine the concentration of Black and Latinos in different California neighborhoods.[112] Even when controlling for income levels, the study revealed that payday lenders are eight times more concentrated in neighborhoods in California that have the

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[103] *Id.*
[104] *Id.*
[105] *Id.*
[106] *Id.*
[107] *Id.* at 1103.
[108] *Id.*
[109] Wei Li et al., *supra* note 96.
[110] *Id.* at 10.
[111] *Id.* at 6-9, 14.
[112] *Id.* at 8.

highest concentration of Black and Latino people.[113] Even though Black and Latino residents of California only make-up one third of the state's population, these communities represent more than 55% of payday loan borrowers in the state.[114] This disproportionate location of payday lenders and the disproportionate numbers of Black and Latino borrowers resulted in the payment of approximately $246 million dollars in loan fees in one year by residents of overwhelmingly Black and Latino neighborhoods.[115]

The CRL's California study is not the only one to report that payday lenders target Black and Latino neighborhoods. Reports conducted analyzing payday lending data from Illinois[116] and from North Carolina[117] also conclude that such lenders are more likely to be located in minority neighborhoods.

Payday lending models are most profitable if consumers become trapped in debt cycles.[118] Payday lenders receive 90% of their revenue from borrowers who average five or more loans per year and 60% of their revenue from borrowers with twelve or more loans per year.[119] Payday lenders do not allow borrowers to make partial payments on their loans.[120] Because payment of the first loan tends to leave borrowers with insufficient funds to cover their expenses until their next paycheck, they often obtain a subsequent payday loan.[121] The CRL study asserts that in California most payday borrowers receive, on average, ten payday loans per year.[122] In some instances,

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[113] *Id.* at 10.
[114] *Id.* at 12.
[115] Wei Li et al., *supra* note 96, at 12.
[116] CONSUMER FED. OF AM., *supra* note 96, at 8 (citing the Woodstock Institute report analyzing pay day loan data collected by the Illinois Department of Financial Institutions in 1999).
[117] We Li et al., *supra* note 96, at 6 (citing a 2005 report sponsored by the Center for Responsible Lending, which found that payday lenders are three times more likely to be located in Black neighborhoods in North Carolina.).
[118] *See* Johnson, *supra* note 4, at *55-56; CONSUMER FED. OF AM., *supra* note 96, at 6 (stating that "[t]he design of these loans leads to frequent roll-overs and perpetual debt").
[119] We Li et al., *supra* note 96, at 2.
[120] Johnson, *supra* note 7, at *3-4.
[121] We Li et al., *supra* note 96, at 24.
[122] *Id.*

payday lenders make loans more appealing by emphasizing only certain information concerning the cost of the loan.[123] For instance, lenders will advertise only the flat dollar amount charged per $100 borrowed by the consumer without explaining that an annual percentage interest rate is applied to the loan or that the interest compounds when a loan is repaid with another payday loan.[124] Research shows that repeat payday borrowers, and most payday borrowers are repeat customers, suffer negative long-term financial problems as a result of their payday loans.[125] In some instances, lenders sue borrowers who default on their loans under civil bounced check laws that allow such lenders to recover treble damages.[126] At the very least, we can say that the interest fees and rollover fees paid to payday lenders over time are monies that borrowers could place in their savings accounts.

This debt trap of rollover fees and interest payments bears a striking resemblance to those practices used to keep Black sharecroppers in a form of debt peonage. Like crop-liens during Reconstruction, payday loans are used with Black communities in disproportionate numbers and such agreements also create a cycle of indebtedness for borrowers. While payday loans are not reinforced with threats of violence, they are accompanied by threats of civil law suit and in some instances criminal charges.[127] Lenders armed with this information know that it is unlikely for a person to default on a payday loan despite the financial consequences of rolling over the loan and paying more fees.[128]

As discussed in a previous section, racism and capitalism have created conditions where Blacks have unequal bargaining power and

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[123] *See id.* at 23 (explaining that payday lenders typically advertise the flat amount charged per $100 dollars borrowed but that survey of borrowers show that they either were not aware of the annual percentage rate charged on the loan or they understated the actual interest rate charged.).

[124] *Id.*

[125] *Id.* at 5 (analyzing payday consumer survey data and payday industry records.).

[126] Johnson, *supra* note 7, at *26; CONSUMER FED. OF AM., *supra* note 96, at 8.

[127] CONSUMER FED. OF AM., *supra* note 89, at 8 (stating that lenders sometimes threaten to use criminal bad check writing laws against defaulting borrowers.).

[128] *Id.* (explaining that payday lenders target vulnerable consumers and that the payday loan model incentivizes lenders to encourage borrowers to roll over loans).

are an easy target for predatory lenders. Therefore, as will be explained in the next section, the federal government has an obligation under CERD to enact legislation that protects Black communities from unfair payday lending terms.

V. THE U.S. RATIFIED CERD, AND THUS IT HAS AN OBLIGATION TO ELMIMINATE PREDATORY ECONOMIC PRACTICES THAT HAVE A DISPROPORTIONATELY NEGATIVE ECONOMIC EFFECT ON BLACK COMMUNITIES AS A RESULT OF DISADVANTAGES CREATED BY RACISM.

Under CERD, a State's failure to regulate predatory economic practices that disproportionately affect Black communities constitutes a failure to "bring to an end, by all appropriate means, including legislation as required by circumstances, racial discrimination by any persons, group or organization."[129] CERD broadly defines the term "racial discrimination" as:

> any distinction, exclusion, restriction or preference based on race, colour, descent, or national or ethnic origin which has the purpose or effect of nullifying or impairing the recognition, enjoyment or exercise, on an equal footing, of human rights and fundamental freedoms in . . . economic . . . life.[130]

Furthermore, a comment by the Committee on the Elimination of Racial Discrimination (hereinafter, "Committee") provided clarification on Article 1(1) stating that "[a] distinction is contrary to the Convention if it has either the purpose or the *effect* of impairing particular rights and freedoms."[131] Therefore, we can say that

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[129] *See generally* CERD, *supra* note 5.

[130] *Id.* at art. 1(1).

[131] Committee on the Elimination of All Forms of Racial Discrimination, Gen. Rec. No. 14: Definition of Discrimination art. 1 (emphasis added), http://www.unhchr.ch/tbs/doc.nsf/(Symbol)/d7bd5d2bf71258aac12563ee004b639e?Opendocument (last visited Aug. 17, 2011).

merchants and lenders who disproportionately use exploitive economic practices in Black communities are engaging in racial discrimination. This premise is further supported by the fact that the Committee regards evidence that certain practices have a disproportionate impact on a race as sufficient evidence of racial discrimination.[132]

Article 2(2) further provides that:

> State parties shall, when circumstances so warrant, take, in the social . . . economic, . . . special and concrete measures to ensure the adequate development and protection of certain racial groups or individuals belonging to them, for the purpose of guaranteeing them the full and equal enjoyment of human rights and fundamental freedoms.[133]

The Committee clarified the language in Article 2 by asserting that "[s]tates should be sensitive towards the rights of persons belonging to ethnic groups, particularly their right to lead lives of dignity . . . to share equitably in the fruits of national growth and to play their part in the Government of the country of which they are citizens."[134]

The language of the Convention and the governing comments depict economic development as a positive right[135] owed to all groups and which should be protected for racial groups that have experienced systematic discrimination. At the time of ratification, the United States took reservation to Article 2(d), maintaining that U.S. domestic law provided sufficient protection from racial discrimination in the private sector.[136] However, the U.S. has not adopted the broad definition of "racial discrimination" articulated in Article 1 of the

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[132] *Id.*

[133] CERD, *supra* note 34 at art. 2 (2).

[134] Committee on Elimination, *supra* note 36 at No. 21.

[135] David Weissbrodt & Connie de la Vega, INTERNATIONAL HUMAN RIGHTS LAW AN INTRODUCTION 70 (Bert B. Lockwood, Jr. ed., Univ. of Penn Press) (2007) (explaining that a positive right creates an obligation for the state to provide a right, this is different from a negative right where a state should refrain from infringing on the rights of the people).

[136] United Nations Treaty Collection, *supra* note 4.

Convention.[137] Therefore, no domestic law exists that provides the comprehensive level of protection required by the language of Article 2. Consequently, this article asserts that the U.S. has failed to meet its obligations under the Convention even in the context of its reservation to the treaty.

This article posits that under CERD, the disproportionate negative financial impact that payday lending has on minority communities, and payday lenders preference for servicing this group with would be sufficient evidence to show racial discrimination under CERD. Many payday lenders target these communities and given the nature of the payday lending model, this decision is costly to Black communities. In that regard, payday lenders impair the ability of Black communities to enjoy economic life on equal footing with Whites. The relationship between racism and capitalism in this country demonstrates how Black communities have historically been more susceptible to exploitive contracts. For these reasons, government action is needed to correct an imbalance that has left Blacks with unequal bargaining power in commercial transactions. The next section of this article suggests that the U.S. government could begin to meet its obligation under CERD by incorporating the definition of "racial discrimination" listed in Article 1 of the Convention into legislation that regulates payday lending in general, and Black communities in particular.

VI. CONGRESS COULD BEGIN TO MEET ITS OBLIGATIONS UNDER CERD BY ENACTING LEGISLATION THAT PROHIBITS THE USE OF "ROLLOVER" TERMS IN PAYDAY LENDING CONTRACTS, CAPS THE INTEREST RATES THAT MAY BE CHARGED TO CONSUMERS, AND LIMITS THE CONCENTRATION OF PAYDAY LENDING ESTABLISHMENTS IN BLACK COMMUNITES.

[137]U.N. OHCHR, Committee on the Elimination of All Forms of Racial Discrimination, Concluding Observations of the Committee on the Elimination of Racial Discrimination, U.S., ¶ 10, CERD/USA/CO/6 February 2008.

Some states have already enacted legislation placing limits on the interest rates that can be charged to payday lender consumers.[138] Congress should enact legislation that prohibits racial discrimination in payday lending by targeting those elements that make such transactions exploitive. In 2005, Congressman Bobby Rush of Illinois introduced the Payday Borrower Protection Act of 2005 (hereinafter, the "Bill") as a bill aimed to protect consumers from "usurious interest rates, exorbitant fees, and perpetual debt."[139]

The proposed law provided that payday loans would only be lawful in those states that promulgated regulations in conformity with the Bill.[140] The Bill would have required state agencies to prohibit a lender from, among other things, accepting repayment of a loan which the lender knows is being paid from the proceeds of another pay day loan,[141] and rolling over a payday loan unless thirty days from the termination of a prior loan to the customer has elapsed.[142] Under the Bill, states would have to force lenders to limit the annual interest rate applied to the payday loan to "the lesser of 36% or the maximum annual percentage rate allowed in the state for small loans."[143]

The Bill should be re-introduced in Congress with an amendment that requires states to impose hefty statutory fines on lenders who engage in racial discrimination. Under this proposed Bill, a lender engages in "racial discrimination," within the meaning of the Bill, if: (1) its payday lending contracts contain any prohibited or otherwise unconscionable terms; or (2) the contracts deviated from the requirements set forth in the Bill; and (3) over 50% of the lender's

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[138] *See* ARIZ. REV. STAT. § 6-1260(F) (Supp. 2001) (LexisNexis 2011) (capping finance fees for payday lending at 15% of the face value of the check for the initial transaction and extensions); COLO. REV. STAT. § 5-3.1-105 (2011) (limiting the finance charge for payday loans to 20% for the first $300 and 45% annually for each payday loan); Fla. Stat. Ann. § 560.404(6) (LexisNexis 2011) (stating that fees charged for a deferred presentment transaction shall not exceed 10% of the payment instrument). Payday loans are also known as deferred deposit loans. Johnson, *supra* note 7, at *9.

[139] Payday Borrower Protection Act, H.R. 1660, 109th Cong. § 4(a) (2005).

[140] *Id.*

[141] *Id.* § 4(b)(6)(E).

[142] *Id.*

[143] *Id* § 4(b)(7)(D)..

borrowers live in neighborhoods highly populated with people from a historically discriminated against race, ethnicity, or national origin.

This statutory fine would have to be significant enough to deter lenders from, not only violating the statute by engaging in unfair lending practices, but also from using such practices in communities, like Black communities, that are more susceptible to them. As previously discussed, studies from the Center for Responsible Lending identify a relationship between a 55% of payday borrowers being Black or Latino and millions of dollars in fees being paid to lenders by these people. Based on this information, requiring the percentage of borrowers from historically discriminated against communities to be less than 50% is an appropriate trigger for this proposed definition of "racial discrimination." Furthermore, the previous version of the Bill required state agencies to force the lender to maintain records appropriate for compliance with the Bill and to submit annual reports containing information that the agency deems necessary to monitor compliance.[144] These provisions should be included in the proposed version of the Bill; lenders should be required to track the demographics of their borrowers[145] and report that information to state agencies. Lenders should record a borrower's address and provide the borrower with the option of identifying his or her race. State agencies could then use census data to monitor average income and overall wealth of communities where payday lenders are concentrated, as done in the CRL's California study. Finally, a portion of the proceeds from statutory fines imposed on violating lenders should be used to fund financial education and debt management programs in minority communities. These programs could help to keep these communities from being vulnerable to exploitive payday lending contracts.[146]

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[144] *Id.* § 4(b)(5)(B).

[145] *See* Elliehausen, *et al.*, *supra* note 93 (noting that few payday advance companies collect customer demographic data on a consistent basis).

[146] *See* We Li et al., *supra* note 89, at 26 (explaining that consumer education programs and alternatives to payday lending could alleviate the use of payday loans).

VII. CONCLUSION

The U.S. government ratified CERD. Accordingly, the U.S. is obligated to apply its definition of racial discrimination domestically. The language of the Convention reflects the international community's understanding that chattel slavery and institutional racism continue to adversely affect the populations that were once subjected to this oppression. States that have ratified the Convention have an obligation to do more than promise not to repeat their mistakes. The Convention requires nations to take affirmative action to correct the social harms caused by racism. Thus far, the United States has failed to satisfy CERD requirements in the arena of predatory lending practices.

When we examine the underlying principles of the theory of unconscionability and the history of racism and capitalism, we have a better understanding of why Black communities are less likely to exert their bargaining power in commercial transactions and thus more susceptible to predatory lending practices. If the government does not deter private commercial institutions, like payday lenders, from taking advantage of this dynamic, then Black communities will continue to be impaired in their ability to enjoy fundamental freedom on equal footing in economic life in the United States.